



**UNITED STATES OF AMERICA  
DEPARTMENT OF TRANSPORTATION  
OFFICE OF THE SECRETARY  
WASHINGTON, D.C.**

Issued by the Department of Transportation  
on the 8<sup>th</sup> Day of September, 2010

**Joint Application of:**

**DELTA AIR LINES, INC.  
VIRGIN BLUE AIRLINES PTY LTD  
VIRGIN BLUE INTERNATIONAL AIRLINES  
PTY LTD D/B/A V AUSTRALIA  
PACIFIC BLUE AIRLINES (NZ) LTD  
PACIFIC BLUE AIRLINES (AUST) PTY LTD**

**Under 49 U.S.C. §§ 41308-41309 for approval of  
and antitrust immunity for alliance agreements**

**Docket DOT-OST-2009-0155**

**ORDER TO SHOW CAUSE**

**I. SUMMARY**

By this Order, the Department of Transportation tentatively decides to deny the application of Delta Air Lines Inc. and above-captioned affiliates of the Virgin Blue Group, together referred to as the “applicants,” who are requesting approval of, and a grant of antitrust immunity for, an alliance and a joint venture between the U.S. and Australia. The tentative decision is based upon our assessment that the proposed alliance would not produce sufficient public benefits to justify a grant of immunity from the antitrust laws at this time.

Applicants for antitrust immunity must meet a high standard. Following deregulation, Congress intended for airlines to compete vigorously, subject, in most cases, to the antitrust laws.<sup>1</sup> Those antitrust laws permit a range of commercial cooperation. Standard “arms-length” activities such as code-sharing, joint marketing, and co-location of airport facilities occur regularly in the airline industry without immunity, are generally pro-competitive, and provide benefits to the traveling and shipping public. Therefore, when airlines request a grant of immunity, they must be able to demonstrate that their proposed alliance will produce substantial benefits that are not otherwise possible unless their request is granted. This high standard is necessary to ensure that alliance partners maintain the ability and incentive to pass on the potential benefits of immunized cooperation to consumers.

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<sup>1</sup> Introduction, Legislative History of the Airline Deregulation Act of 1978, Report 96-5, Published May 1979.

The applicants in this case have not made a strong showing of public benefits. First, the proposed cooperation arrangements evidence that there are barriers to integration between Delta and the Virgin Blue Group that, at best, will delay the realization of public benefits, and, at worst, could prevent any substantial benefits from being achieved at all. The applicants have elected to limit the scope of their cooperation to focus primarily upon the “trunk routes” between the U.S. and Australia. This limited scope reduces the potential benefits that are possible from a grant of antitrust immunity. Moreover, having recently decided to form an alliance, after entering a new market, the applicants have virtually no experience as commercial partners and employ business processes that they admit are not compatible. In brief, they have only just begun to explore the feasibility of arms-length cooperation, much less the degree of cooperation that requires, or would merit, a grant of antitrust immunity. There is little evidence at this point to conclude that the proposed alliance will benefit consumers to the degree necessary to justify a grant of antitrust immunity.

Second, the conditions in the U.S.-Australia market are in an extraordinary state of flux. Since the applicants entered the market independently, prices and capacity have changed dramatically. In these circumstances, the applicants have not shown that immunized cooperation would yield substantially more public benefits than a continuation of the current competition between them.

Our approach to this case is consistent with past cases. We have emphasized the high standard necessary to justify a grant of immunity and the need for applicants to demonstrate that substantial public benefits are likely to be produced at the time the immunity is requested. For example, in the SkyTeam case in 2005, we tentatively denied a request for antitrust immunity because there was both insufficient information in the record to make a complete assessment of public benefits and the competitive conditions were in flux. There, as in this case, the Department identified barriers to integration that we believed reduced the incentives of the airlines to integrate their operations and pass on the benefits of immunized cooperation to consumers.<sup>2</sup>

We direct interested parties to show cause why we should not make final the tentative findings and conclusions.

## **II. BACKGROUND**

The applicants filed a joint application on July 9, 2009<sup>3</sup> requesting approval of, and a grant of antitrust immunity for, commercial alliance agreements related to their service in the U.S.-Australia market. The applicants “envision that the scope of their cooperation will involve primarily transpacific service to and from the South Pacific region, including Australia initially, and

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<sup>2</sup> See SkyTeam, Docket OST-2004-19214, Show Cause Order 2005-12-12 at 2, 30, and 37 (December 22, 2005).

<sup>3</sup> Joint Application at 5 (July 9, 2009). In their July 9, 2009 filing, the applicants seek approval of, and antitrust immunity for, the following agreements, to be made effective immediately upon the issuance of a Final Order: (i) Bilateral alliance cooperation agreements between Delta, on the one hand, and Virgin Blue, V Australia, Pacific Blue Airlines (NZ), and Pacific Blue Airlines (Aust), on the other hand; (ii) A multilateral alliance coordination agreement among the Joint Applicants; (iii) A multilateral joint venture agreement among the Joint Applicants; and (iv) Any existing and future implementing agreements in furtherance of the foregoing agreements and any transaction undertaken pursuant to any of the foregoing agreements.

potentially New Zealand in the future.”<sup>4</sup> Despite the limited geographic scope of the alliance, the applicants are requesting an unrestricted grant of immunity covering their potential cooperation in any market worldwide.

To supplement the information in the application, the Department requested additional evidence from the carriers on December 1, 2009. The Department received that evidence on January 15 and February 3, 2010.<sup>5</sup> The Department subsequently declared the record substantially complete on March 5, 2010, with comments and replies due on March 26, 2010.<sup>6</sup> Additionally, the Australian Competition & Consumer Commission granted authorization for the joint venture on December 10, 2009.<sup>7</sup>

The record in this case consists of the joint application, documents and data submitted in support of the application, and one pleading by the Delta Master Executive Council of the Air Line Pilots Association, which supports the application.<sup>8</sup> No other pleadings have been filed.

Although the applicants plan to enter into a series of commercial agreements, the focus of the proposed alliance will be a new joint venture alliance, which they claim will enable them to expand U.S.-Australia and U.S.-South Pacific price and service options and to compete more effectively with Qantas Airways and United Air Lines.<sup>9</sup> The applicants state that

[t]ogether, [they] will be a stronger and more effective new entrant challenger by offering consumers: (1) a greatly expanded array of online destinations, (2) greater frequency and time of day travel choices, (3) additional nonstop transpacific services and (4) more attractive pricing through commonly aligned commercial incentives and joint venture efficiencies.<sup>10</sup>

Together, the alliance agreements create a framework for cooperation in the areas of planning, pricing, revenue management, marketing, and operations. The applicants state that the revenue-sharing alliance is envisioned as a

tactical, stand-alone alliance by Delta and V Australia for U.S.-South Pacific service, and does not include any other immunized or non-immunized members of SkyTeam. Nor does it involve any cooperation between Delta and any other entity with a relationship with the Virgin Group, e.g. Virgin Atlantic or Virgin America.<sup>11</sup>

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<sup>4</sup> Joint Application at 5 (July 9, 2009).

<sup>5</sup> See Joint Applicants’ Response (posted on January 19, 2010) and (posted on February 4, 2010).

<sup>6</sup> Notice Establishing Procedural Schedule (March 8, 2010).

<sup>7</sup> Determination, Application for Authorisation Lodged by Virgin Blue Airlines Pty & Others in Respect of a Joint Venture Between the Applicants. Authorisation no.: A91151, A91152, A91172 & A91173. Public Register no.: C2009/1317 (December 10, 2009), available at <http://www.accc.gov.au/content/index.phtml/itemId/881766/fromItemId/401858>.

<sup>8</sup> See Comments of Delta Master Executive Council of the Air Line Pilots Association, International (April 7, 2010).

<sup>9</sup> See Joint Application at 1-2 (July 9, 2009).

<sup>10</sup> Joint Application at 3 (July 9, 2009).

<sup>11</sup> Joint Application at 5-6 (July 9, 2009).

If the application is approved, the applicants state that the proposed alliance will create a broader and more optimized joint network with new nonstop and online service. In addition, they contend that, with a common financial objective, broader codesharing will result in lower fares through the elimination of so-called “double marginalization”<sup>12</sup> pricing, and a greater availability of discount seats through improved access to expanded inventory. Finally, they claim that there will be enhanced competition against the much larger incumbent carriers, and that a grant of antitrust immunity will enhance the economic viability of their new services in the face of a slowing economy, rising oil prices, and weakened demand.<sup>13</sup>

The applicants assert that, to achieve these benefits, they need to be able to agree on service and capacity, jointly plan schedules/routes, align economic incentives, work together toward common economic interests, jointly establish prices and fares, and jointly determine inventory allocations and share revenues, among other activities. They further maintain that neither carrier alone can offer the comprehensive network and depth of schedule options to compete on par with Qantas and United. The parties claim that, without a grant of antitrust immunity, they will not go forward with the alliance agreements, and thus will only provide limited arms-length codesharing and frequent-flyer cooperation.<sup>14</sup>

### III. DECISIONAL STANDARDS

Under 49 U.S.C §§ 41308-41309, we normally engage in a two-step analysis of foreign air transportation agreements submitted for our approval. We first determine under § 41309 whether the agreements are adverse to the public interest because they would substantially reduce or eliminate competition (the “competitive analysis”). If so, we determine whether they are necessary to meet a serious transportation need or to achieve important public benefits. If we make that finding, we approve the agreements, provided that those public benefits cannot be met or achieved by reasonably available and materially less anticompetitive alternatives. U.S. foreign policy goals are a key element of these benefits. A party opposing approval has the burden of showing that the agreement or request would substantially reduce or eliminate competition and that less anticompetitive alternatives are available. On the other hand, the party seeking approval of the agreement or request must establish the transportation need or public benefits.

If we approve the agreements under the analysis outlined above, we next decide whether there are sufficient public benefits to grant immunity under 49 U.S.C. § 41308 (the “public benefits

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<sup>12</sup> Double marginalization, also called multiple mark-ups, occurs when two airlines have basic interline or codeshare arrangements to handle multiple segments but are unwilling to cooperatively price the combined itinerary for the consumer. Thus, for example, Airline A is not willing to accept a cooperative price for the segment it operates because it risks losing revenue to Airline B, which might operate the longer, more profitable segment in the itinerary. The consumer is ultimately not offered the most competitive fare or optimal routing. However, in a “metal-neutral” sales environment, with revenue- or benefit-sharing, the airlines can balance risks and benefits for the benefit of the consumer and alliance as a whole. The airlines are willing to cooperatively price itineraries and make seats available because they share the same economic incentive to make the sale and share the revenues. *See generally* Whalen, W.T. A Panel Data Analysis of Code Sharing, Antitrust Immunity, and Open Skies Treaties in International Aviation Markets, Review of Industrial Organization, 30: 39-61 (2007).

<sup>13</sup> *See* Joint Application at 8 (July 9, 2009).

<sup>14</sup> *See* Joint Application at 29 (July 9, 2009).

analysis”). Under § 41308(b), Congress has given the Department the authority to exempt airlines from the antitrust laws to the extent necessary to allow a proposed transaction to proceed, provided that the exemption is *required by* the public interest. While the public interest determination under both sections 41309(b) and 41308(b) entails a comparison of anti-competitive effects and public benefits, the standard in section 41308(b) (“required by” rather than “not adverse to”) is higher.<sup>15</sup> If we determine that the transaction *would* substantially reduce or eliminate competition, yet meets the test for approval under section 41309(b)(1), then we *must* exempt the parties to the transaction, pursuant to 49 U.S.C. § 41308(c).

In this case, we will proceed directly to the public benefits analysis. Of course, we cannot grant antitrust immunity unless we have approved the alliance agreements under section 41309. Our analysis in this Order assumes *arguendo* – as the applicants have argued – that the alliance agreements should be approved because they do not substantially reduce or eliminate competition in any relevant market. This is the same approach that we took in the SkyTeam case in 2005.<sup>16</sup> As explained below, we tentatively find that, even if the alliance agreements were to be approved under section 41309, the applicants have failed to make their case that a grant of antitrust immunity is required by the public interest under section 41308.

#### IV. TENTATIVE DECISION

We have tentatively decided to deny the applicants’ request because they fail to show that the proposed alliance will generate sufficient public benefits to justify a grant of antitrust immunity. As a matter of course, we require applicants for antitrust immunity to identify and demonstrate public benefits that will flow from the immunized cooperation, and our orders granting antitrust immunity under section 41308 make detailed findings regarding the existence of those benefits and the likelihood that they will be realized.<sup>17</sup> The inquiry must examine the particular facts and circumstances of the case. It is not our policy to confer antitrust immunity simply on the basis of an assertion alone that agreements do not violate the antitrust laws. We are only willing to grant immunity if the parties to agreements would not otherwise go forward without it, and if we find that the public interest requires that we grant it.<sup>18</sup> Based on past cases, we require the applicants to make a strong showing that the public benefits will be substantial and proximate to a grant of antitrust immunity.<sup>19</sup>

Unlike many past alliance cases where the applicants sought a grant of antitrust immunity to enhance or expand their existing commercial relationships, here the applicants are seeking immunity before they have developed any significant commercial links. At the time this application was filed, the applicants had just begun to explore a commercial relationship, and both were serving

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<sup>15</sup> See, e.g., Star Alliance, Docket OST-2008-0234, Show Cause Order 2009-4-5 at 18 (April 7, 2009), *quoting* Northwest/KLM, Order 93-1-1, at 11 (January 11, 1993).

<sup>16</sup> See SkyTeam, Docket OST-2004-19214, Order 2005-12-12 at 32-33 (December 22, 2005).

<sup>17</sup> See, e.g., oneworld, Docket OST-2008-0252, Show Cause Order 2010-2-8 at 30-32 (February 13, 2010).

<sup>18</sup> See, e.g., Star Alliance, Docket OST-2008-0234, Show Cause Order 2009-4-5, at 17 (April 7, 2009).

<sup>19</sup> See Star Alliance, Docket OST-2008-0234, Show Cause Order 2009-4-5 at 17-19 (April 7, 2009); SkyTeam, Docket OST-2007-28644, Show Cause Order 2008-4-17 at 13-16 (April 9, 2008); Star Alliance, Docket OST-2005-22922, Show Cause Order 2006-12-17 at 16-20 (December 18, 2006); SkyTeam, Docket OST-2004-19214, Show Cause Order 2005-12-12 at 34 (December 22, 2005).

the U.S.-Australia market for the first time. It had only been six months since Virgin Blue's long-haul unit, V Australia, initiated service to the United States, and it had been less than one month since Delta initiated its first services to the Australian continent. Delta and the Virgin Blue Group are still working to adapt to the U.S.-Australia market and complete the necessary steps to create a viable commercial relationship, which requires experience in evaluating the market-specific commercial conditions, linking reservations systems, identifying markets in which to codeshare, and establishing procedures to market and sell each other's services. This process is likely to take some time given that the Virgin Blue Group comprises three distinct airlines that are managed separately, and given that the Group is considering a series of new strategic options, which could affect the applicants' implementation of the immunized alliance.<sup>20</sup>

Moreover, the applicants are seeking antitrust immunity for a "tactical"<sup>21</sup> alliance focused on a single market, the U.S.-Australia market. The market is an ultra-long-haul, thin market with only a few nonstop routes and relatively few intermediate connecting options. As shown in a subsequent section of this order, the applicants' new entry has dramatically changed the market's structure, contributing to significantly lower fares and substantially increased capacity. The context is unprecedented – an historically static market that has experienced a sudden and significant increase in capacity by airlines that have no prior experience in the market and that are proposing to form a new alliance.

The applicants argue that the proposed alliance will deliver a range of valuable public benefits, enabling the applicants to preserve and expand the network; optimize and expand codesharing and improve online service; eliminate inefficient multiple markups and reduce fares; and reduce costs and create efficiencies that will be passed on to consumers.<sup>22</sup> The Department has carefully analyzed the details of the proposed cooperation agreements. As explained below, several factors in this case – in particular, the barriers to integration that exist between the parties and the prevailing market conditions – suggest that the applicants are not yet in a position to deliver the most substantial of these benefits, and also that many of the benefits would not likely be obtained and passed on to consumers in a timely manner.

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<sup>20</sup> In June 2010 the Virgin Blue Group announced that it had begun to change the airline group's commercial strategy, while it also is creating partnerships with carriers from several different global alliances. It is "set to overhaul its business operations in order to re-establish the carrier as a corporate-focused airline, including dropping international and domestic routes and reassessing brand names." See Virgin to overhaul operations: report, *BusinessSpectator*, June 3, 2010, available at <http://www.businessspectator.com.au/bs.nsf/Article/Virgin-to-overhaul-operations-report-pd20100603-62PL4?opendocument&src=rss>. Also, on June 30, 2010, the Virgin Blue Group announced that it is to bring its "long-haul offshoot V Australia within the main airline group . . ." See Borghetti announces new Virgin exec team, Jordan Chong, *The Sydney Morning Herald*, June 30, 2010, available at <http://news.smh.com.au/breaking-news-business/borghetti-announces-new-virgin-exec-team-20100630-zmkn.html>.

<sup>21</sup> See Joint Application at 5 (July 9, 2009).

<sup>22</sup> See Joint Application at 17-28 (July 9, 2009).

## A. Barriers to Integration

### 1. Realization of Fare Benefits

The applicants state that, “with a common financial objective, broader codesharing will result in lower fares through the elimination of . . . ‘double marginalization’ . . . and a greater availability of discount seats through improved access to expanded inventory.”<sup>23</sup> The applicants also maintain that a “grant of antitrust immunity will eliminate inherent inefficiencies to pricing and enable the Joint Applicants to offer more attractive fares to consumers.”<sup>24</sup>

In several recent antitrust immunity cases, applicants have emphasized that they would be able to lower fares and improve inventory allocation. Where the Department has given weight to such promised benefits, it has done so because alliance partners produced detailed and comprehensive alliance agreements that aligned pricing and selling functions across the joint network and readily allowed large-scale pricing efficiencies to be passed on to consumers.<sup>25</sup> However, the facts of this case suggest that there are barriers to such integration between Delta and Virgin Blue Group that would diminish the potential benefits arising from the reduction of double marginalization. Further, there are comparatively few markets in which fare reductions are possible because the applicants have limited the scope of their cooperation by focusing on trunk routes in essentially a single bilateral market, the U.S.-Australia market.<sup>26</sup>

A key distinguishing characteristic of this joint venture is that each airline within the Virgin Blue Group – V Australia, Virgin Blue, and Pacific Blue (Aust/NZ) – is managed separately. As stated by the applicants, “Virgin Blue and V Australia have distinct business models and distinct revenue management teams that operate each network on a different process and systems infrastructure.”<sup>27</sup> This separate management structure has resulted in different pricing and revenue management systems, which is likely to impair the alliance partners’ ability to coordinate pricing across the whole network, including especially behind and beyond sectors, and to optimally allocate seats. While these separate management structures do not preclude the possibility of a commercial alliance that is pro-competitive and beneficial for the traveling public, they do raise questions about the applicants’ ability to expeditiously achieve the pricing efficiencies and network integration that they discuss in their application.

Although the applicants argue that these and certain technological compatibility issues are being addressed,<sup>28</sup> they do not give a detailed explanation of how the issues will be addressed or how the

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<sup>23</sup> Joint Application at 7-8 (July 9, 2009).

<sup>24</sup> Joint Application at 23 (July 9, 2009).

<sup>25</sup> See Star Alliance, Docket OST-2008-0234, Show Cause Order 2009-4-5 at 19 (April 7, 2009); SkyTeam, Docket OST-2007-28644, Show Cause Order 2008-4-17 at 14-15 (April 9, 2008); Star Alliance, Docket OST-2005-22922, Show Cause Order 2006-12-17 at 18 (December 18, 2006).

<sup>26</sup> See Joint Application at 5 (July 9, 2009) (Stating that the alliance will involve primarily *transpacific* services); Joint Applicants’ Response at 16 (January 15, 2010) (Stating that the applicants will share revenue and closely coordinate on *transpacific* services). See also Joint Applicants’ Response at 8-13 (January 15, 2010).

<sup>27</sup> Joint Application at 27 (July 9, 2009).

<sup>28</sup> See Joint Applicants’ Response at 26-28 (January 15, 2010).

separate processes would be reconciled if we were to grant antitrust immunity.<sup>29</sup> Therefore, the applicants have failed to provide us with sufficient information to support their claims of public benefits.

Another distinguishing factor in this case is the nature of Delta's network on the West Coast of the United States. Delta provides service from the West Coast to some domestic U.S. points with its own aircraft. Additionally, Delta has arms-length relationships with otherwise non-associated U.S. and foreign air carriers to provide more feed for Delta's long-haul flights. While the applicants argue that these arms-length relationships will provide additional network connectivity for the joint venture partners, antitrust immunity is not required to maintain these arrangements and the applicants have not explained how immunity would enhance the present benefits.<sup>30</sup>

## 2. Network Expansion

The applicants also argue that "[t]he coordination and integration made possible through the antitrust immunized Joint Venture and other alliance activities will enable the Joint Applicants to maximize the number of new travel options for consumers and communities with improved and expanded nonstop and on-line services."<sup>31</sup> We see two issues of concern here. First, the initial scope of the joint venture agreement is limited by excluding flow markets in each region, such as Canada, Mexico, New Zealand, and other Oceanian destinations despite the applicants' request for unrestricted global immunity.<sup>32</sup> These exclusions significantly reduce the potential benefits that could result from their partnership.

Second, while the Department has indicated in past cases that alliances may facilitate capacity expansion and additional nonstop service, we have also stated that antitrust immunity is not required as a legal or operational matter to launch new routes.<sup>33</sup> It is true that, in some circumstances, new capacity is likely to be added more quickly where alliance partners have integrated their services and there are existing pro-competitive arrangements to aggregate behind and beyond traffic and to share risks. However, this means of capacity expansion in the near term presupposes that the airlines have an established and functional commercial relationship, as well as some experience flowing passengers over each other's networks.<sup>34</sup>

Here, the applicants have just recently begun to link their networks, and the potential of their commercial alliance, as well as the potential of their own services in the market, is not yet known. Although cooperation, instead of competition, may allow the applicants in this case to provide consumers with some product enhancements, we tentatively find no basis to conclude that the proposed immunized alliance will add significant capacity in the near future given the significant increase that has recently occurred. Further, the applicants have not made a convincing case that antitrust immunity would enable them to achieve consumer benefits that would not otherwise be

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<sup>29</sup> See Joint Applicants' Response at 26-28 (January 15, 2010).

<sup>30</sup> See Joint Application at Exhibit JA-14 (July 9, 2009).

<sup>31</sup> See Joint Application at 19 (July 9, 2009).

<sup>32</sup> See Joint Application at 5 (July 9, 2009).

<sup>33</sup> See, e.g., oneworld, Docket OST-2008-0252, Show Cause Order 2010-2-8 at 31 (February 13, 2010).

<sup>34</sup> See Joint Applicants' Response at 3-7 (January 15, 2010).

possible. Thus, we are tentatively not persuaded that a grant of antitrust immunity is required at this time.

### 3. Increased Codesharing

The applicants state that, with immunity, they would provide “unfettered codesharing resulting in new online city-pairs, new routings, improved elapsed travel times and improved time of day coverage.”<sup>35</sup>

As with the introduction of new routes, it is possible for antitrust immunity to enable comprehensive codesharing across a large network; however, immunity is not necessary to enable codesharing, and the Department must carefully scrutinize a request for immunity when the purported public benefits depend to a significant extent upon the applicants’ desire to expand codesharing.

On July 8, 2009, the applicants filed, concurrently with their immunity request, an application for blanket codeshare authority based on services between the U.S. and Australia/New Zealand, which was approved by the Department on September 1, 2009.<sup>36</sup> With that authority, the applicants began codesharing in January 2010. Despite having the authority for a much broader codeshare relationship, the number of markets in which the applicants are actually codesharing is limited. We acknowledge the applicants’ argument that they risk diverting revenue if they were to fully open up their networks to each other.<sup>37</sup> However, in the particular circumstances of this case, we tentatively find that the mere possibility of revenue diversion is not sufficient to justify a grant of antitrust immunity. The decision to grant antitrust immunity instead hinges upon an assessment of the benefits for consumers, compared to the existing codeshare relationship, and the reasons why broader codesharing is not possible absent a grant of antitrust immunity. Because the applicants have just begun to explore codesharing – having started in January of this year – there is not enough information in the record to make this assessment. Thus a grant of antitrust immunity has not been justified at this time. Meanwhile, the applicants continue to have blanket codeshare authority and the option to pursue an arms-length relationship as a means of expanding their codesharing and providing consumers with the benefits of more online service.

### 4. Efficiencies and Cost Reductions

The applicants state that they “will coordinate and cooperate on joint procurement activities in an effort to reduce costs.”<sup>38</sup> The applicants list some potential activities that may increase efficiencies and result in cost reductions, including volume/bulk purchasing, common specifications for goods/services, joint bidding, joint negotiations with suppliers, and the use of standardized contracts for goods/services in the areas of general goods/services, maintenance services, field

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<sup>35</sup> Joint Application at 7 (July 9, 2009).

<sup>36</sup> Blanket statements of authorization under 14 CFR Part 212 to permit the joint applicants to engage in code-sharing services to the full extent permitted by the U.S.-Australia Open Skies Agreement and the Multilateral Agreement on the Liberalization of International Air Transportation (MALIAT). Notice of Action Taken, Docket DOT-OST-2009-0156 (September 1, 2009).

<sup>37</sup> Joint Application at 27 (July 9, 2009).

<sup>38</sup> See Joint Application at 25 (July 9, 2009).

station support, catering, aircraft ground equipment acquisition and sales, fuel, information technology, and courier services.

While this list shows the potential efficiencies of coordinated operations, the Department does not believe that there is adequate information in the record – and the applicants do not have a sufficiently defined commercial relationship – to properly evaluate these claims. Where applicants have little or no experience as alliance partners and have not worked together previously on the joint activities, the applicants must meet a high standard to demonstrate that the public benefits resulting from their efficiency claims are valid. In this case, the applicants have merely stated that they will explore potential efficiencies and cost reductions in the future.<sup>39</sup> Accordingly, there is no basis at the present time to identify sufficient benefits to justify a grant of antitrust immunity.

## 5. Virgin Blue Group Restructuring

The Virgin Blue Group is currently in the process of implementing several strategies simultaneously with carriers from different global alliances, which highlights another issue within this case that complicates the public benefits analysis. Any number of strategic decisions that ultimately may be made by the Virgin Blue Group could alter the carrier relationships in the region with an associated effect on consumer benefits.

While we recognize the efforts by the Virgin Blue Group to adapt in a dynamic marketplace, the Department notes that the carrier group has publicly stated that it intends to make some significant strategic decisions that would affect this application.<sup>40</sup> Moreover, the fact that New Zealand and other Oceanian destinations are mentioned in the application as potential regions to be included in the future, but are excluded from the current alliance implementation plans, calls into question whether some of the network benefits noted by the applicants will materialize. We note that, for example, the Virgin Blue Group filed an application with the Australian Competition & Consumer Commission for a joint venture with Air New Zealand across the Tasman Sea, which if approved, may affect the consumer benefits possible from a grant of immunity in this case. Thus, in light of the Virgin Blue Group's strategic review, the applicants have not provided sufficient evidence to show that they are prepared to implement the alliance as described in the application and deliver the promised public benefits.

## B. Market Conditions

The U.S.-Australia market is in an extraordinary state of flux. When the applicants submitted their application, both carriers were new entrants in the market, having initiated service during 2009 in the midst of a major global recession. Capacity levels in and among many intercontinental

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<sup>39</sup> See Joint Application at 25 (July 9, 2009).

<sup>40</sup> In June 2010 the Virgin Blue Group announced that it has begun to embark on a much more aggressive strategy to transform the airline group, while it also is creating partnerships with carriers from several different global alliances. It “is set to overhaul its business operations in order to re-establish the carrier as a corporate-focused airline, including dropping international and domestic routes and reassessing brand names.” See *Virgin to overhaul operations: report*, *BusinessSpectator*, June 3, 2010, available at <http://www.businessspectator.com.au/bs.nsf/Article/Virgin-to-overhaul-operations-report-pd20100603-62PL4?opendocument&src=rss>. Also, on June 30, 2010, Virgin Blue Group announced that it “is to bring its loss-making, long-haul offshoot V Australia within the main airline group . . .” See Borghetti announces new Virgin exec team, Jordan Chong, *The Sydney Morning Herald*, June 30, 2010, available at <http://news.smh.com.au/breaking-news-business/borghetti-announces-new-virgin-exec-team-20100630-zmkn.html>.

markets were stagnant or declining, as were fares and overall revenues. According to the International Air Transport Association (IATA) international scheduled air traffic demand in 2009 dropped 3.5 percent, which was the largest ever post-war decline; and while yields began to improve at the end of 2009, they were still 5 to 10 percent lower than 2008.<sup>41</sup>

The applicants are proposing to cooperate in the U.S.-Australia market at a time when fares have decreased and capacity has increased largely *as a result* of their respective competitive entries into the market. Thus, the current market conditions make it extremely difficult to determine the effects of a grant of antitrust immunity on the competitive structure of the market and the associated impact on consumers.

The competitive effects of the added service have been especially pronounced because the U.S.-Australia market is an ultra-long-haul, thin market that for years has been served on a nonstop basis by two incumbents, Qantas and United.<sup>42</sup> The market is undergoing a structural shift as four airlines now are competing in the market, including an additional large U.S. network airline (Delta) and a new start-up focused on providing a premium product on long-haul, point-to-point routes (V Australia). These and other facts in the record indicate fundamental changes and vigorous price competition. The applicants readily state that

[p]rices in the U.S.-Australia market in general, and the Los Angeles-Sydney market, in particular, have been pummeled in the last year by suppression of demand caused by the global economic recession and concerns about the H1N1 virus, as well as by the introduction of large scale capacity increases in a market that had been stagnant for many years.<sup>43</sup>

Seat capacity in this market, unlike other intercontinental markets, is up substantially due to Delta's and V Australia's entry into the U.S.-Australia market. While service in most other U.S. to international markets was either stagnant or declining last year, seats between the continental U.S. and Australia increased 19.3% from 2008 to 2009. This occurred even as the incumbent carriers, Qantas and United, collectively decreased capacity just over 3%, despite Qantas deploying the A380 in the market in October 2008.<sup>44</sup> Delta and V Australia together provided 18.7% of total seats in the market in 2009 versus 0% in 2008.<sup>45</sup>

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<sup>41</sup> See 2009: Worst Demand Decline in History – Encouraging Year-end Improvements, Anthony Concil, January 27, 2010, available at <http://www.iata.org/pressroom/pr/Pages/2010-01-27-01.aspx>.

<sup>42</sup> Excluding Hawaii and the outlying U.S. territories.

<sup>43</sup> Joint Applicants' Response at 23 (January 15, 2010).

<sup>44</sup> DOT T100 Onboard Data, 2008 versus 2009, excluding Hawaii and the outlying U.S. territories. Qantas, which operates over twice the capacity that United does in the continental U.S. to Australia market, decreased its capacity 6.6% year-over-year, while United increased capacity 5.6% from 2008 to 2009.

<sup>45</sup> DOT T100 Onboard Data, 2008 versus 2009, excluding Hawaii and the outlying U.S. territories.

<b>Seat Capacity Change – Continental U.S. to World Regions<sup>46</sup></b>	
<b>Region</b>	<b>December 2009 vs. 2008</b>
<b>Australia</b>	<b>19.3%</b>
<b>Europe</b>	<b>(8.7%)</b>
<b>Far East</b>	<b>(8.1%)</b>
<b>South America</b>	<b>3.6%</b>

Given current market conditions, the applicants have not made a convincing case that a grant of antitrust immunity would produce any substantial consumer benefits that are not available today. As shown above, the new competition in the market has provided consumers with some benefits from lower prices and increased capacity. While price and capacity levels may change in the future, as economic and competitive conditions change, the applicants must still make a strong showing now that a grant of antitrust immunity would produce benefits that are not otherwise possible to achieve. While the applicants state that they expect capacity to continue to increase and prices to remain competitive if their joint venture were to be approved,<sup>47</sup> they do not provide any detailed information in the way of analysis or evidence to support their claims. Thus, we tentatively conclude that they have not met their burden.

The applicants argue that a grant of antitrust immunity is necessary for them to compete effectively. They claim that “standing alone, neither Delta nor the Virgin Blue Carriers can offer a comprehensive network, or depth of schedule options, to compete on par with the established incumbents.”<sup>48</sup> The applicants state that “absent a Joint Venture, Delta and V Australia would be placed at a structural disadvantage...”<sup>49</sup>

Given the particular facts and circumstances of this case, we are not persuaded by this argument. For the first time, we are being asked to grant an antitrust exemption to help two carriers establish a better position versus incumbents in essentially a single bilateral market that is open to competition. In this regard, a grant of antitrust immunity could serve primarily to enhance the position of specific competitors in this market and not, as in past cases, a means to enhance competition and enable airlines to achieve efficiencies and benefits that are not otherwise possible given the legal restrictions in international aviation. The weight of the evidence suggests that the primary effect of a grant of antitrust immunity at this time would be to improve the market share of Delta and V Australia, without certainty that the applicants will be making structural improvements in the market that would create large-scale public benefits, such as increased capacity, lower fares, or more efficient services. Given the barriers to integration that we have identified, and the current market conditions, the applicants have not provided sufficient evidence to show that the proposed alliance would produce substantial benefits for consumers to the extent justifying a grant of immunity.

<sup>46</sup> DOT T100 Onboard Data, 2008 versus 2009, excluding Hawaii and the outlying U.S. territories.

<sup>47</sup> Joint Applicants’ Response at 22-25 (January 15, 2010).

<sup>48</sup> See Joint Application at 3 (July 9, 2009).

<sup>49</sup> Joint Applicants’ Response at 24 (July 9, 2009).

## V. CONCLUSION

After conducting a detailed public benefits analysis of the proposed alliance, the Department tentatively finds that the applicants have not met the high standard necessary to justify a grant of antitrust immunity. In the circumstances of this case, the applicants have not adequately shown that a grant of antitrust immunity will allow the proposed alliance to produce sufficient additional public benefits. Evidence in the record, commercial developments, market conditions, and the provisions of the joint venture agreement demonstrate that the likelihood of realizing many of the most substantial benefits claimed by the applicants – increased capacity, lower fares, and more efficient services – are in doubt.

Therefore, we tentatively conclude that a grant of antitrust immunity is not required by the public interest at this time.<sup>50</sup>

### ACCORDINGLY:

1. We direct all interested persons to show cause why we should not issue an order making final our tentative findings and conclusions, denying the instant application to grant antitrust immunity to existing and future alliance agreements between and among Delta Air Lines, Inc. (along with its affiliates), Virgin Blue PTY LTD, Virgin Blue International Airlines PTY LTD d/b/a V Australia, Pacific Blue Airlines (NZ) LTD, and Pacific Blue Airlines (AUST) PTY LTD ;
2. Objections or comments to our tentative findings and conclusions are due no later than 14 calendar days from the service date of this order, and answers to objections shall be due no later than 7 business days thereafter; and
3. We will serve this Order on all parties on the service list in this docket.

By:

**SUSAN L. KURLAND**  
Assistant Secretary for Aviation  
and International Affairs

(SEAL)

*An electronic version of this document is available at: <http://www.regulations.gov>*

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<sup>50</sup> See 49 U.S.C. §§ 41308(b).